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SENSITIVE
SIPDIS

State for EAP/CM - SFlatt, PPark
State for EEB/IPE - RWatts, JUrban, TMcGowan
State for EEB/CIP - SFlynn, FSaeed
USTR for China Office - TStratford, TWineland, AWinter
USTR for IPR Office - JRagland, SMcCoy
Commerce for National Coordinator for IPR Enforcement
Commerce for MAC NMelcher, JWu, ESzymanski
Commerce for MAS RLayton, SMathews
LOC/Copyright Office - STEpp
USPTO for International Affairs - LBoland, EWu, STong
DOJ for CCIPS - MDubose and SChembtob
FTC for Blumenthal
FBI for LBryant
DHS/ICE for IPR Center - DFaulconer, TRandazzo
DHS/CBP for IPR Rights Branch - GMacray, PPizzeck
ITC for LLevine, LSchlitt

E.O. 12958: N/A

TAGS: [ETRD](#) [EIND](#) [KIPR](#) [ECON](#) [CH](#)

SUBJECT: CHINA MISSION 2009 SPECIAL 301 RECOMMENDATION

This cable is sensitive but unclassified and is not for Internet distribution.

Ref A: State 8410
Ref B: 2009 Guangzhou 0043
Ref C: 2008 Beijing 4527
Ref D: 2009 Chengdu 0030
Ref E: 2009 Shanghai 0059
Ref F: 2008 Shanghai 0232
Ref G: 2008 Shanghai 0233
Ref H: 2008 Shanghai 0546
REF I: 2008 Guangzhou 0720
REF J: 2008 Guangzhou 0438

11. (U) This cable responds to Ref A seeking Post input for the annual 2009 Special 301 Review.

12. (SBU) Post recommends that China continue to be placed on the Priority Watch List with Section 306 monitoring. A World Trade Organization (WTO) dispute settlement panel on January 26, 2009 found that China was deficient in important aspects of its intellectual property rights (IPR) regime under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). China's notorious markets, optical media piracy, online piracy, and production and export of counterfeit goods and counterfeit pharmaceuticals all remained serious problems. While there were some positive developments, including robust enforcement activities surrounding China's hosting of the 2008 Olympic Games, China's IPR enforcement regime is still widely regarded as ineffective and non-deterrent. Several U.S. businesses and industry associations reported that China's IPR environment did not deteriorate markedly in the past year and was more or less "the same." However, recent reports that suggest the global

economic downturn may lead in China to judicial policies that could reflect the selective enforcement of IPR laws. If such reports are confirmed, rights holders could face serious challenges in China in the coming year.

WTO Dispute Settlement

13. (SBU) Following the April 2007 request by the United States for WTO dispute settlement consultations with China over deficiencies in China's legal regime for protecting and enforcing IPR, the Chinese government suspended most bilateral discussions with the United States on IPR matters and cancelled a large number of previously planned collaborative IPR activities. Despite this suspension, however, some agencies and municipalities continued cooperation with the United States despite the central government suspension. In addition, the Chinese government continued to work on IPR programs, such as the EU's IPR2 initiative, that did not involve the United States. Following a more than 18-month suspension, the Chinese agreed (after a mandate by Vice Premier Wang Qishan) to resume the bilateral dialogue on September 4-5, 2008 for the IPR Working Group under the Joint Commission on Commerce and Trade (JCCT). On October 15, 2008 the WTO dispute settlement panel unofficially ruled that China was TRIPS-inconsistent in its denial of copyright protection to works undergoing content review, as well as in the improper disposal of infringing goods by China Customs. On a third point, however, the panel found it had insufficient evidence to support the U.S. claim that criminal thresholds for prosecution in China's criminal law are so high as to allow commercial-scale counterfeiting and piracy to occur without the possibility of criminal prosecution. The

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panel made its official decision on January 26, 2009.

IPR Working Group and JCCT

14. (SBU) On September 4 and 5, the U.S.-China bilateral dialogue on IPR was officially resumed under the auspices of the JCCT IPR Working Group in Beijing (see Ref B). In preparatory meetings and throughout the event itself, the Chinese side emphasized that the session should focus on rebuilding confidence in the IPR dialogue rather than seek overly ambitious outcomes. Nevertheless, both sides agreed during the event on a substantial list of cooperative activities, including a concrete objective to move ahead with MOUs on trademark, copyright, and patent cooperation before the end of the year. At the September 16 JCCT plenary meeting in California, China and the United States agreed to continue meetings of the IPR Working Group and pursue cooperative activities on issues such as IPR and innovation; copyright and internet piracy; counterfeit goods at wholesale and retail markets; and other issues of mutual interest. Both sides also agreed to further discuss China's patent law amendments; pharmaceutical data protection; and the bilateral customs Memorandum of Cooperation.

MOUs Signed with SAIC, NCAC, SIPO

15. (SBU) On October 24, the United States and China signed three memoranda of understanding related to IPR. First, USPTO and the State Administration for Industry and Commerce (SAIC) established a general framework for bilateral cooperation between the two agencies on trademarks and unfair competition. A second with the National Copyright Administration of China (NCAC) outlined cooperation on issues related to copyright administration and enforcement. Finally, a third MOU with SIPO will continue to deepen the cooperation between the two agencies, which USPTO officials describe as increasingly extensive and generally strong.

In early 2009, counterpart agencies were drafting respective work plans for each MOU. These are expected to include bilateral and multilateral technical level exchanges, and cooperation initiatives such as "how to file" programs, which directly benefit Chinese and U.S. patent applicants. In addition, USPTO will in 2009 again host at least one Chinese patent examiner from SIPO at

its Foreign Examiners in Residence program, in which foreign examiners travel to the United States to participate in the same eight-month training program as new U.S. patent examiners.

Developments in IP Legislation

¶6. (SBU) On December 27, 2008 the National People's Congress passed the third major revision to China's Patent Law, which will go into effect on October 1, 2009. The new law contains some provisions, including those related to data protection and compulsory licensing, that are of concern to foreign rights holders. However, the State Council Legislative Affairs Office conducted the revision process in a relatively transparent manner, making the law available several times for public comment periods, and making some changes to the draft that reflected input received from public comments. China's Trademark Law and Copyright Law are similarly undergoing review for possible amendment.

Ambassador's IPR Roundtable

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¶7. (SBU) On November 6-7, Embassy Beijing hosted the seventh annual Ambassador's Roundtable Discussion on IPR in China. Whereas in 2007 Chinese government officials refused to participate because of the pending WTO case, in 2008 five Chinese IP officials attended. The event included a keynote address by Assistant Minister of Commerce Chong Quan and presentations by SIPO National IP Strategy Office Deputy Secretary General Wu Xiaoming; State Council Legislative Affairs Office (SCLAO) Director General Zhang Jianhua; NCAC Copyright Department Deputy Director Xu Chao; and China Trademark Office (CTMO) Deputy Director General Lu Zhihua. While the speakers' comments did not reveal major developments in China's IPR policies, their presence at the event marked a positive step toward renewed bilateral cooperation on IPR.

¶8. (SBU) Ambassador's Roundtable participants, mostly U.S. businesses, were surveyed during the event for their views on the IPR environment in China. With only 27 respondents, the findings are not conclusive, but are as follows: one-third said IPR protection in China was better than the year before; more than one-half said IPR protection in China was the same as the year before; nearly two-thirds said the IPR challenges they face in China were the same as the year before; more than two-thirds said Chinese IPR protection/enforcement was ineffective.

Innovation Conference

¶9. (SBU) The "China-United States Innovation and Commercialization Conference" was held in Beijing on December 2, two days prior to the fifth Strategic Economic Dialogue (SED). Co-sponsored by the Chinese Ministry of Science and Technology (MOST) and the U.S. Departments of State and Commerce, the conference launched the innovation component of SED V and was a follow-up to the December 2007 innovation conference convened in conjunction with SED III. Participants, half of whom represented Chinese government and industry, underscored the need for more bilateral collaboration in exploring innovation. The U.S. side in particular stressed the virtues of open innovation in contrast to indigenous, or "self-reliant," development policies, and most speakers emphasized that the current economic crisis provides an opportunity to enhance global innovation. Business, academic, and government speakers from both countries explored a variety of themes, including the importance of standardization, IPR protection, government policies and support, and the conditions and measures that produce a "culture of innovation."

Data Protection

¶10. (SBU) According to the Pharmaceutical Research and Manufacturers of America (PhRMA), China in 2008 did not provide

meaningful data protection to multinational pharmaceutical companies that brought pharmaceutical products with new chemical entities into China. A recent independent study focused on the period January 1, 2003 to June 30, 2008 demonstrated the inadequacy of data protection in China. The study showed that, since 2003, shortly after Chinese law incorporated the data protection provision of TRIPS, 49 pharmaceutical products containing new chemical entities (NCE) have been introduced in China by 21 multinational pharmaceutical companies. As many as 18 of these NCE products are severely affected by domestically manufactured products, which are essentially the same as the

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original NCE product but were nevertheless all approved as "new drugs" in China. There are a significant number of non-original manufacturers in China making NCE products whose equivalent generic drug was approved either before or shortly the NCE product.

These facts, said PhRMA, show that China has yet to provide meaningful data protection to NCE originator companies.

Enforcement

¶11. (SBU) Microsoft reported to Emboffs in February 2009 that a number of cases conducted in 2008 represented milestones in enforcement of the company's IPR by Chinese authorities. However, the company said the cases are not significant in the broader context of Microsoft's experience in China, where the company's revenues are vastly smaller than would be expected given the size of the computer market.

¶12. (SBU) On April 14, 2008, the Qingdao Intermediate People's Court ruled that defendant Qingdao Ultimate Transportation Equipment Co., Ltd., a Sino-U.S. joint venture, must pay 1.72 million RMB (USD 250,000) in damages to three plaintiffs, including Microsoft. In 2006, BSA filed a civil suit with Qingdao Intermediate People's Court after failing to reach a settlement with Ultimate. The case was built on evidence obtained through a raid by Qingdao's Copyright Administration against Ultimate. The defendant appealed to the Shandong Province High People's court and the court reaffirmed the decision in October, 2008. The case is significant because it was the first winning end user civil court case brought by Microsoft in China, as well as the highest damage awarded by the China court to foreign software rights holders.

¶13. (SBU) On July 14, 2008, Shanghai Pudong People's Court sentenced two criminal defendants to serve 2-3 years for making and selling altered volume discount agreements under the Microsoft Open License Program. The case, brought to the Pudong PSB by Microsoft, was significant because it was the first ever case involving a fake license, as opposed to counterfeit disks. The Supreme People's Court recognized the significance of the case by naming it one of its Top 10 Criminal Cases in the past 30 years.

¶14. (SBU) On August 15, 2008, Suzhou Public Security Bureau detained and froze the assets of Hong Lei, the founder of TomatoLei.com, a website offering free downloads of pirated Microsoft Windows, Office, and popular software from Adobe, Symantec, Autodesk, and other companies. The case, which was made possible by effective coordination between the Microsoft, NCAC, and the MPS, had a significant impact on the Chinese software market and led to the closure by Suzhou PSB of a number of similar websites. The case was transferred to the Procuratorate in November 2008.

¶15. (SBU) On December 31, the Shenzhen Futian District People's Court convicted 11 defendants in China's largest-ever copyright counterfeiting case. Sentences ranged from 1.5 to 6.5 years, the longest ever handed down by China's courts for a software copyright crime. The decision ended a 17-month prosecution and involved the largest group of pirates punished by the court in a single case. The convictions were a result of milestone collaboration between the FBI and China's Ministry of Public Security (MPS), and disrupted a criminal syndicate believed to be

the largest software counterfeiting group in the world,

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responsible for manufacturing and distributing 13 different counterfeit Microsoft software products in 11 languages to 36 global markets. Li Shunde, a legal scholar who heads the Chinese Academy of Social Sciences Intellectual Property Research Center, told China's Xinhua news agency "This [case] shows China's sincerity in implementing intellectual property law enforcement."

¶16. (SBU) Dahon Technologies, Ltd., a U.S. bicycle maker with extensive retail and manufacturing activities in mainland China, reported that local courts in Shenzhen awarded monetary damages to the company in seven separate patent infringement cases against Chinese firms in 2008. Despite these successes, company representatives said they faced continuing IPR infringement risk due to lax enforcement of IPR regulations at trade fairs throughout China. Several other Guangzhou-based rights holders and law firms have separately described trade fair-related IPR concerns as an area that did not significantly improve in 2008, even as trade fair organizers and local government Intellectual Property Offices established complaint desks and assigned full-time officials to settle IPR-related disputes during most major fairs (see Ref I). One rights holder described officials ignoring repeated IPR infringement complaints for three consecutive years as the company escalated its complaints and repeatedly sued fair organizers, local government officials, and companies that allegedly violated the firm's IP during the fairs. The rights holder said fair organizers eventually implemented new procedures and stepped up enforcement in time for the 2008 annual fair in order to prevent the company from filing additional law suits.

¶17. (SBU) Shanghai continues to be a bright spot in East China's IPR enforcement. The city's IPR white paper, published in 2008, highlights Shanghai's efforts. Shanghai has particularly boosted transparency through such efforts as posting its IP strategy online for public comment and live broadcasts of IP case trials via the Internet. Shanghai PSB has also begun a new initiative to more proactively investigate IP cases based on credible leads rather than waiting for the criminal threshold to be met before beginning an investigation. However, counterfeit retail markets continue to be a problem in the city (see Ref G).

¶18. (SBU) Shanghai courts, which receive high marks from the U.S. business community for their professionalism and fairness, are attracting large numbers of both foreign and domestic litigants. Shanghai has taken a number of measures since October 2008 to highlight and strengthen its judicial capabilities. On October 29, Shanghai established the Shanghai Intellectual Property Arbitration Court with the support of the Shanghai IP Administration and the Shanghai Arbitration Commission (SAC). By establishing a special IP Arbitration Court, Shanghai hopes to gain a similar reputation for its arbitration abilities (see Ref H).

¶19. (SBU) The Jiangsu High Court is likewise gaining recognition in the U.S. business community for its progress and increasing capacity for dealing with IP cases. The Jiangsu High Court emphasizes compelling the infringer to disclose all infringement information and imposes civil sanctions in addition to damages under certain circumstances.

¶20. (SBU) Guangdong Provincial and Local courts, especially in Guangzhou and Shenzhen, resumed IP-related cooperation and exchanges with the United States in 2008 after a hiatus of almost two years. Court officials met with U.S. officials and described continuing efforts to improve the handling and enforcement of IPR

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cases. Guangdong High Court also welcomed visiting U.S. federal judges and prosecutors in conjunction with exchange programs cosponsored by USPTO and Guangdong IPO (see Ref J). Guangdong Customs and Guangdong Administration of Industry and Commerce (AIC)

also resumed cooperative product identification training for each agency's front-line inspectors by inviting U.S. officials and rights holders to directly participate.

¶21. (SBU) However, rights holders continued to report challenges in inter-agency cooperation on IPR-related cases among China's different administrative and law enforcement agencies. Although rights holders said cooperation with individual agencies generally improved in 2008, they repeatedly complained about situations in which successful investigations and enforcement actions failed to be effectively transferred from one agency to another for continued action or the next step in the enforcement process. For example, cases successfully investigated by a local AIC reportedly languished and remained incomplete after transfer to the Public Security Bureau for further criminal investigation. More frequently, rights holders reported that Public Security Bureau criminal cases were inexplicably refused or simply disappeared after being referred to Procuratorates for trial, meaning that the results of the administrative and criminal investigations were never considered by a Chinese court. Lack of an effective evidence discovery process and prohibitively high enforcement thresholds remain major problems for rights holders when attempting to enforce their IPR rights in China (see Ref J).

¶22. (SBU) NCAC reported that, from April 1 to May 31, 2008, it launched a nationwide special action to combat the preloading of infringing software on new computers by manufacturers and resellers. By strengthening the supervision and inspection of computer manufacturers and large-scale computer markets, NCAC said the rate of preloaded genuine operating system software increased to 85 percent. However, Microsoft estimates that only 35 percent of such software is genuine, up from 15 percent in 2005.

¶23. (SBU) Chinese authorities in 2008 received positive attention in the media for making IPR enforcement a national priority, especially against unlicensed goods bearing the Olympics logo. The campaign implemented broad efforts to protect Olympic Sponsors and China's image as the host, and included a propaganda campaign to place monthly news stories about protecting the Olympics logo. Many of the largest sponsors of the Games praised the government's efforts to protect their brands in some of the most public Olympic venues. However, there were many reports that unlicensed products in Beijing's notorious markets were simply driven underground in the cat-and-mouse game with law enforcement officials that is so familiar to Beijing's vendors.

Notorious Markets

¶24. (SBU) Baidu.com has in previous years been identified by industry as the largest China-based "MP3 search engine" with deep links to unauthorized downloads of copyright-protected files. In February 2008, International Federation of the Phonographic Industries (IFPI), representing Sony BMG Music, Warner Music, Universal Music, and Gold Label Entertainment, filed a \$9 million music copyright infringement suit in a Beijing court against Baidu and a \$7.5 million suit against Sohu.com. Baidu officials continue to deny responsibility for the content hosted by other websites, but told Emboffs in February 2009 that the company does

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provide a mechanism for rights holders to request the removal of links to infringing content. Domestic rights holders are also suing Baidu. In March 2008, the Music Copyright Society of China (MCSC) and R2G, a leading music distributor, announced anti-piracy action against the company, citing infringement of material including Olympics-themed songs. The MCSC and R2G said they turned to the courts after failing to reach a private settlement with the search engine giant, charging Baidu with stonewalling, delaying tactics, and using distorted interpretations of the law.

¶25. (SBU) At physical markets in China, the widespread availability of counterfeit goods in and around Beijing's markets continued to be a problem. Widespread infringement continued at long-time hotspot markets such as Jiayi, Yuexiu, and Yaxiu. Unofficial visits to Jiayi after 5:00 p.m., when police and

copyright officials leave for the evening, reveal dedicated vendor stalls, closed during daylight hours, that sell exclusively Louis Vuitton and Coach products. Both of those brands, along with dozens of others, have been prohibited for sale in all Chinese wholesale markets since 2004. Problems at the notorious Silk Street Market and Hongqiao Market also remained severe. A January 2008 report from industry claimed that the situation remains "horrid," with a survey of the market revealing piracy levels that increased in most categories from 2007 to 2008.

¶26. (SBU) In December 2008, a coalition of brands including Burberry, Chanel, Gucci, Louis Vuitton, and Prada reached a settlement agreement with Silk Street Market management. Under the terms of the deal, the market's management company agreed to suspend vendors caught selling infringing goods. While the settlement has been enforced and some stalls shut down, such actions in February 2009 elicited angry responses from vendors, who protested and threatened employees of the agency in Beijing that represents the brands. As a result, suspensions were delayed and notarized purchases, the process by which transactions involving counterfeit goods are recorded for use as evidence in court, were disrupted. The law firm representing the brands in the settlement agreement is investigating whether Beijing government and Silk Street authorities have capitulated to demands of the vendors in order to avoid conflict. Threats to social stability, particularly during the current economic downturn, have been rumored in some cases to be hindering authorities' willingness to enforce laws (see para 43).

¶27. (SBU) In 2008, while Beijing played host to the Summer Olympic Games, Silk Street market management reported more than 1.6 million visitors to the market, its highest numbers in three decades. Wang Zili, general manager of Beijing Silk Street Co., Ltd., which manages the market, was repeatedly quoted in the local media during the Olympics touting the surge in visitors. In a September 2008 meeting with USTR officials, the Chaoyang District Government's Commerce Bureau, which oversees the market, cited visits to Silk Street by former U.S. President George H. W. Bush and other dignitaries as a validation of, and support for, the market's legitimacy.

¶28. (SBU) In Shanghai, while production of IPR infringing goods is reportedly decreasing, purveyors of infringing goods, both on the streets and with small retail establishments, remain largely unchecked. In July 2006, Shanghai closed its premier counterfeit market, Xiangyang. However, several other markets have sprung up and thrived in its place, and many Xiangyang merchants simply moved to these other locations throughout the city, including the Shanghai Yatai Shenhui Recreational Shopping Center, Fengxiang

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Fashion and Gift Market (located in the same building as the Shanghai IP Service Center), and the Shanghai Longhua Fashion and Gift Market.

¶29. (SBU) In Guangdong Province, notorious markets in Shenzhen and Guangzhou have shown signs of increased attention to IPR protection, but the total volume of infringing goods at such markets has not seen a major decline. At Shenzhen's Luohu Market, signs have been posted at most entrances and exits reminding visitors that the sale of infringing goods is prohibited, and notices are occasionally posted on closed stalls indicating that those stalls were shut down for violating IPR regulations. However, sales of infringing goods continue to openly take place in other stalls in the same markets, and the increased attention to IPR enforcement appears to have forced the sellers of higher quality counterfeits further underground. Sellers of high quality fakes, including brand name purses, clothing, and accessories, as well as DVDs, CDs, and other digital media, increasingly escort customers to hidden back rooms within the market or to apartments in adjacent buildings where the better quality fakes are stored and transactions take place.

Internet Piracy

¶30. (SBU) China has the world's largest and fastest-growing Internet population, which increased more than 41 percent to nearly 300 million users from 2007 to 2008. The United States, with the second largest number of Internet users, had approximately 223 million during the same period. However, China's rate of Internet penetration is only 23 percent, still relatively low compared with 71 percent in the United States. More than 90 percent of Chinese Internet users, approximately 270 million people, were estimated to use a high-speed Internet connection, allowing them to download larger files including movies, television shows, and video games. The launch in 2009 of China's third-generation mobile phone services, which support wireless Web surfing, is expected to cause a further surge in Internet usage in coming years. According to statistics from the China Internet Network Information Center (CNNIC), there were more than 13 million websites with a .cn domain name in December 2008. The Internet environment in China has created opportunities for widespread piracy and challenges for law enforcement.

¶31. (SBU) In addition, China's internet population is increasingly watching streaming video of foreign television programs and movies rather than waiting to buy DVD or VCD discs, with the video content available on a burgeoning number of domestic and international websites featuring new and old television programs that often become available for viewing within hours of their initial broadcast. Hobbyist groups have also formed in China with television and computer enthusiasts volunteering to compile translations of foreign programs and upload home-made subtitles to the new programs as soon as new videos become available on Chinese streaming video websites, making the content more accessible to an even broader Chinese audience.

¶32. (SBU) Chinese officials reported campaigns to crack down on online piracy at various times throughout 2008 with varying degrees of success, and hundreds of infringers were reportedly ordered shut down. In March 2008, China's National Anti-Pornography and Anti-Piracy Office, under the General Administration of Press and Publication (GAPP) announced that it had shut down an unspecified number of domestic websites in a

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crackdown on pornography and piracy. The office at the time also reported that a number of cases in Guangdong, Anhui, and Hubei provinces had resulted in arrests. Amendments to China's copyright law, which for many years has been under review for revision, are expected to better address issues of online piracy.

¶33. (SBU) From June 1 to September 30, 2008, the Chinese government went to great lengths to launch a broadly coordinated crackdown on the unauthorized retransmission of sporting events and other activities related to the Beijing 2008 Olympic Games. A working group composed of NCAC, MPS, MIIT, and the State Administration of Radio, Film and Television (SARFT) initiated 24-hour monitoring of video websites. The nationwide enforcement efforts reportedly resulted in 453 online infringement cases, of which 192 sites were shut down, 173 sites were required to remove infringing content, 88 sites received administrative punishment, usually fines, and 10 sites were transferred to the Procuratorate for prosecution. According to monitoring by the International Olympic Committee, the vast majority of illegal retransmissions subsequently happened outside of China, indicating a successful campaign.

Production, Import, and Export of Counterfeit Goods

¶34. (SBU) Statistics released by United States Customs and Border Protection (CBP) in January 2009 revealed that China was again the United States' top trading partner for IPR seizures, accounting for 81 percent of the total value of counterfeit products seized at United States borders for full year 2008. Hong Kong (five percent) and Taiwan (one percent) were in third and fourth place, respectively. While the proportion of seizures from China increased slightly from 80 percent in 2007, the total value of goods seized jumped more than 40 percent in the same period to \$221 million from \$158 million. (Note: Globally, CBP reported

that the total value of all IPR seizures in 2008 increased nearly 39 percent from 2007. End note.) More than 96 percent of footwear,

the top commodity seized in 2008, originated in China. More troubling, perhaps, is that China, India, and Hong Kong, the top three trading partners for IPR seizures overall, accounted for 94 percent of all seizures of products posing potential safety or security risks.

135. (SBU) In December 2007, U.S. Customs and Border Protection entered into a non-binding memorandum of understanding (MOU) with the General Administration of Customs of the People's Republic of China (GACC) to better exchange information on border seizures of counterfeit goods. While technical and internal challenges on both sides have reportedly slowed the responsiveness, data sharing between the customs agencies has been generally useful, and led to some successful seizures in 2008.

Optical Media Piracy

136. (SBU) The massive problem of Internet piracy has overshadowed optical disc piracy because of its scale and efficiency. However, the music and movie industries continue to be plagued by optical disc piracy in China and by China-made pirated optical discs across Asia. These discs fuel the pirated DVD sellers that seem to be ubiquitous in Chinese cities (see Ref D). Industry reports that little seems to be done about infringing optical disc plants in China, and notes in particular a lack of criminal

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investigations. Industry finds especially problematic the inability to send suspicious optical discs directly to forensic testing centers such as the one in Shenzhen. Although they regularly exchange information with the facility, the current requirement is that discs be submitted via local law enforcement or publishing companies, a burden that complicates investigations.

Changing this policy requires approval by the Ministry of Public Security.

137. (SBU) At a November 21, 2008 roundtable with U.S. business representatives in Shanghai, and at a separate roundtable event in Guangzhou on December 2, USG officials discussed Internet-related IP enforcement in China. Business representatives outlined some of the hurdles they face on IP protection, most notably the verification of pirated DVDs and CDs. Businesses confirmed their difficulty finding an agent to verify pirated copies despite the presence of the government lab in Shenzhen that has testing capabilities. In even the most obvious cases of pirated DVDs, they said, Chinese enforcement authorities insist on a report from a neutral agent.

Use/Procurement of Government Software

138. (SBU) In its fifth annual survey of packaged PC software piracy, released in May 2008, the Business Software Alliance (BSA) showed that, accounting for new information on China's PC market, the real piracy rate in 2007 dropped two points to 80 percent. BSA credited new vendor agreements with OEMs that took effect in 2007, and said that more China-based companies becoming multinational enterprises added incentive to comply with international IPR standards. BSA reported that the number of PCs shipped to homes and small businesses, a group with higher infringement levels, grew faster than the market as a whole, especially in second- and third-tier cities, but not enough to offset progress made to date legalizing larger customer segments, such as government and enterprise. However, BSA also explains in its report that previous studies had underestimated the number of China's non-brand name vendors, a group with a higher rate of piracy than other vendors. This discovery increased the overall estimate of China's PC market by 25%, and also raised the piracy rate. Therefore, BSA's official 2007 ranking shows that China's piracy rate remained at 82 percent for a second consecutive year, with the acknowledgement that China is demonstrating progress in

fighting PC software piracy in the government, large enterprises, and even consumer and small business markets, which represent two-thirds of the country's software market. BSA's preliminary estimates show China's 2008 piracy rate at 79 percent, continuing a downward trend.

¶39. (SBU) As in previous years, the Chinese Government objected to BSA's methodology, which it said is flawed because it accounts only for packaged software, which they argue represents only a portion of China's software market. Instead, China relies on its own study, conducted by Chinese research firm Chinalabs. In June 2008, Chinalabs released its annual report on software piracy, announcing that China's software piracy rate was in fact only 41 percent in 2007 - half the 82 percent piracy rate reported by BSA.

The study indicated that the general software piracy rate had dropped 10 percentage points from 2006 to 2007, while the piracy rate in operating systems had declined 29 points from 2006 to 39 percent in 2007.

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¶40. (SBU) On January 12, 2009, Zhejiang Copyright Department Director Wang Shaojie said that the financial crisis has made their work more difficult as companies are more tempted to cut corners by using pirated software. Nevertheless, Wang vowed that the Copyright Bureau would continue to urge companies that are still in operation to buy legitimate software. He said the Zhejiang Copyright Bureau plans to assist Zhejiang companies to buy software worth RMB 100 million (USD 15 million) from Microsoft,

though it is unclear how this will be funded (see Ref E).

Treaties -----

¶41. (SBU) China acceded to the 1996 WIPO Copyright Treaty (WCT) and WIPO Performances and Phonograms Treaty (WPPT), known as the "Internet Treaties," in June 2007. Since then, China's legislature has not promulgated any laws or regulations to implement these two treaties, because China's current Copyright Law, revised in 2001, meets all the requirements provided in the WIPO treaties. As a result, the Chinese government can use the Copyright Law to implement the two treaties without drafting a new implementing law or regulation.

¶42. (SBU) The Chinese government on September 1, 2008 notified WIPO that it would extend the application of the Internet Treaties to Hong Kong effective October 1, 2008. The notification superseded China's statement in 2007 that, unless otherwise notified, the Internet Treaties would not apply to Hong Kong or Macao.

Recent Developments -----

¶43. (SBU) Since December 2008, there have been a number of developments in China that appear to indicate a potentially troubling trend toward protectionism and nationalism and selective application of the rule of law. In a December 10 press interview with a local reporter, Supreme People's Court (SPC) Third Division Court Vice President Judge Kong Xiangjun reportedly said the SPC would study "how to adjust IP judicial policies" to mitigate the effect of the global financial crisis on China's economy. Reports said Kong suggested that if infringing activity did not "violate public interest," the infringer would be allowed to continue the infringing activity, but be required to pay damages to the rights holder. China's 21st Century Business Herald quoted an SPC source saying that the SPC had already distributed the new guidelines internally even as the policy deliberations continue. The SPC and SIPO at the time denied knowledge of the issue. A Xinhua media report from the same day, however, credited Judge Kong with telling local courts to apply a stricter compensation rule in the case of infringements, and to set up more IPR tribunals - statements more in line with China's current legal requirements to cease all infringing activities (see Ref C).

¶44. (SBU) In January 2009, SPC President Wang Shenjun stressed to local deputies in Henan province that Chinese courts must serve the overall situation of the country, with a focus on better servicing the nation's top priority: stable and fast growth. Reinforcing those statements, the SPC's Third Division (the IPR division) published on its website its 2009 "Focuses of Work," which include "taking full advantage of the functional role of IP trials to provide judicial support to enterprises in enhancing

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indigenous innovation capabilities, market competition capabilities, and risk resistance capabilities."

¶45. (SBU) Reports from Guangdong confirm that the policy is being put into practice. Local media reports announced that the Guangdong Communist Party's (CPC) Disciplinary Inspection Committee and the Guangdong Procuratorate have each announced measures to ease law enforcement efforts in cases where punishment might impact the ability of a major firm to maintain economic growth. Business and legal contacts in the province have warned that legal resolution of commercial disputes, especially IPR civil cases, has measurably weakened as court officials express doubts about upholding judgments that might cause defendant companies to go out of business or shed local workers.

¶46. (SBU) China IP expert Danny Friedman suggested to Econoff that "the Chinese ministers might feel that their hands are tied. On the one hand, they want to enforce intellectual property rights, but on the other they do not want to increase unemployment and cause soQnrest by putting whole villages out of work that are sustained by manufacturing counterfeit products. This is a fortiori so, because of the economic downturn."

Comment

¶47. (SBU) Reports from industry suggest that the IPR environment in China continues to receive increased awareness and benefited from sufficient enforcement actions to prevent significant deterioration in the past year. During the Olympics, China's government launched a highly visible campaign to protect certain aspects of IPR. However, progress has not been sufficiently consistent or sustained to change the widespread perception of China's enforcement regime as largely ineffective and non-deterrent. The suspension of the bilateral IPR dialogue continued for much of 2008 as a result of China's petulant response to the United States' 2007 WTO filing. While some gains appear to have been made following the resumption of bilateral talks in September 2008, the cooperation to which both sides agreed will not result in concrete action until later in 2009. The long-awaited third revision of China's Patent Law included many provisions, such as compulsory licensing, that are troubling to the foreign IPR community. Furthermore, the rumored selective enforcement of IPR laws, motivated by the economic downturn, suggests we need continued pressure on the Chinese Government to cooperate in bilateral and multilateral fora, and to take measurable action to improve the IPR environment in China. In this context, Post recommends that China continue to be placed on the Priority Watch List with Section 306 monitoring. End Comment.

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